Chapter 4

What Is the Price of Cutting Up Your Credit Cards?

"You must know the difference between good debt and bad debt."

— Rich dad

So what is wrong with cutting up your credit cards?

To me, cutting up your credit cards is much the same as a person who needs to lose weight and who goes on a crash diet. Faithfully, one diets for a month, living only on three carrot sticks per meal, and for dessert after dinner you have four ounces of plain yogurt. After thirty days you cannot stand the pain any longer. One day in the mall, a young worker from the chocolate chip cookie company offers you one small sample. The aroma of those fresh-baked cookies is overpowering to the senses, so you say to yourself, "Oh go ahead. You've been good. Just have a small piece of that cookie." Suddenly, you find yourself buying a bag to "take home to the family," but the bag of cookies never leaves the shopping mall. The binge is on and soon you are ten pounds heavier than you were when you started the diet. The action of crash dieting leads to the reaction of overindulging.

The people that know me, know that I do not have the answer for the yo-yo diet. If I did have the diet that guaranteed permanent weight loss, I would be richer than Bill Gates. But unfortunately, I personally know only too well what it feels like to diet and then go back on an eating binge. In my family, I am the only one with a weight problem, a problem I have struggled with since childhood, so I cannot blame family genetics. While I do not have the solution for instant weight loss, I do have a solution for binge spending and credit card debt, and cutting up your credit card is not part of that solution. But again, my solution comes with a price and once more the question will he, "Are you willing to pay the price?"

Beauty and the Beast

A friend of mine and his wife are models of physical beauty. They are slim, trim, and healthy. Dieting is not an issue for them. Working out at the gym is not a problem either. Managing their money is a different story. Both are in their late forties making a lot of money, but they also spend so much money, it frightens most people who know them. These are the people that pay off their old credit cards with their new credit cards. When they max out on their home equity loans, they buy a bigger house. In other words, they work hard making a lot of money, just to *push the string forward*. They also have a full-time maid and a nanny for their kids. They have more cars, more toys, more clothes, more lavish vacations than people making ten times more than they do. They are physically beautiful people but their beast is their lack of financial restraint.

We have been great friends for years, so when we get together, they get on me for my lack of food and exercise discipline and I get on them for their lack of financial discipline. As I said earlier, we all have our different challenges in life. Mine is food and theirs is money.

The Rich Have More Debt Than the Poor

I love spending money, but Kim and I are not foolish with our money. Hove having the finer things in life. I love having the choice of flying first class or economy. I love tipping people well, if they have given great service. I also don't tip if the service was rotten. I love giving bonuses when extra money comes into the company. I love making my friends rich when our investments do well. I love the freedom that money buys. I love working if I want to and not working if I don't. So for me, money is fun, money buys me more choices, and most importantly, it has bought Kim and me the *freedom* from the drudgery of earning a living. That is why I do not understand people who say, "Money does not make you happy." I often wonder what they do for fun.

When someone says, "Cut up your credit cards," I don't think it makes people happy. One of the main reasons people spend money is to make themselves happy. Now, there are people who carry such need for financial happiness to extremes, just as there are people who exercise and diet to extremes. But in my opinion, the main reason cutting up credit cards does not work in the long run is because cutting back on doing things you enjoy does not make most people happy. Given the choice, people would rather have more money and have the freedom to enjoy life more. The only people who say "Money does not make you happy" are either people who already have a lot of money and are still unhappy, or people who would not know what being happy is anyway. In my opinion, it's not money that makes you unhappy. It's not being able to pay your bills or not having the money to do the things you would love to do, that tends to make people unhappy.

In the late 1970s, my company made millions of dollars very quickly in my nylon and Velcro surfer wallet business. Being in my late twenties, the money and success went straight to my head or, should I say, my ego. Each time I looked at the company's balance sheet and saw the money piling up, I felt more and more elated. I became cocky and arrogant. I thought that with each dollar increase, my IQ increased also. Unfortunately, it worked exactly the opposite for me. As my dollars were going up, my financial IQ was actually going down. Soon, I was into fast cars and faster women. The experience of fast cars and fast women was fun and I don't regret that time in my life, but it was a time that couldn't last. The pain of going from being a *paper* millionaire to suddenly being a person with nearly a million dollars of *real* debt, was a sobering experience. (Which is why I am concerned with so many people today who have their portfolios filled with paper assets, feeling rich. There is a very big difference between paper assets and *real* assets, paper wealth and *real* wealth.)

After losing my first million, I went to see rich dad to ask for his advice. Looking over my financial statement, all he could do was shake his head and finally say, "This is a financial train wreck." And then he proceeded to chew me out. Yet, as I said about the value of mistakes, that "financial train wreck" and the reprimand that followed were some of the best lessons of my life. The value from that mistake has been priceless and continues to serve me well today. Although that failure cost me nearly a million dollars, in the long term it also made me many more millions and will continue to make me even more money in the future. As stated earlier, making a mistake and learning from it can be a priceless experience. Making a mistake, then lying, blaming, denying, or pretending you did not make a mistake, is a waste of a good mistake. Today, when I find myself in the middle of a new mistake, I say to myself, "Keep your head. Don't blow your cool. Pay attention, and learn from this experience. This seemingly had experience will serve you well if you are willing to learn from it. Pay attention and learn as much as you can while you're in the middle of it."

Becoming a paper millionaire in my late twenties and then becoming a loser with a million dollars in real debt was a horrible experience. I wish I could say I paid attention and truly appreciated the experience while the house of cards was coming down. But I didn't. I blamed, I lied, I denied, and I tried to run from my responsibilities. The good thing was, I had my rich dad, who pinned me down and made me stop blaming and start learning one of the biggest lessons of my life.

Good Debt into Bad Debt

After my big learning experience, and once rich dad was through chewing me out, he said, "You have successfully converted a million dollars of *good* debt into a million dollars of *bad* debt. Not too many people make such big mistakes. You can learn from this experience or you can run from it. You choose." As I said, mistakes can be priceless experiences, but when in the middle of one, it is often difficult to realize the value of your stupidity. Nonetheless, that "financial train wreck," as my rich dad called it, was filled with valuable lessons. One of the most important lessons I learned was to face my mistakes, learn from them, and try not to repeat the mistake. That was the most important lesson in a chain of many important lessons because I chose to "face the music," as they say.

Another important lesson was on good debt and bad debt. I did not really understand the concept, at least not as clearly as I did at that moment. My rich dad had often cautioned me about good debt and bad debt. He would say, "Every time you owe someone money, you become an employee of their money" He would explain that to his son and me that good debt was debt that someone else paid for you, and bad debt was debt that you paid for with your own sweat and blood. That was why he loved rental real estate and he would add, "The bank gives you the loan, but your tenant pays for it." I had heard the concept and I understood it intellectually, but now I was learning the difference between good debt and bad debt with my body, my mind, and my spirit. Today when I see people simply rolling their credit card debt into a home equity loan I cringe. They may think it's a good idea, and the government offers you a tax break for doing so, but today I know better.

All they have done is take very expensive short-term bad debt and turned it into less expensive long-term bad debt. It may bring them temporary relief but it does not solve the problem. They have turned their credit card debt into a second mortgage, and for those of you who have read my other books, you know that the word *mortgage* comes from the Old French word *mort*, which means *death*. In other words, *mortir* means "an engagement until death." Like my friends who work hard only to get deeper in debt, they continue to push the string forward, and not learn the lesson. Unless something changes, they will be engaged until death with bad debt.

After I lost everything, I felt terrible, blamed others for my mistakes, and wanted to run from my problems. Rich dad forced me to face my mistakes. Going over the numbers was a painful yet very useful process. By facing my mistakes, it was obvious that I could not possibly work hard enough to pay off all the debt. Most people only lose a little at a time, pushing the string of debt slowly forward. But when you lose a lot of money, the pain and reality of a lot of bad debt is sobering. It was life-changing for me. When you lose $100,000, or are $100,000 in debt, it is possible for most people to physically work hard and pay off that much debt. But when it's a million dollars, hard physical work was not going to cut it, at least with my limited earning capacity.

Once rich dad had calmed down, he looked at me and said, "You can walk away from this experience and pretend it never happened. Or you can make it the best experience of your life." For those of you who have read our second book, *Rich Dad's CASHFLOW Quadrant*, and our third book, *Rich Dad's Guide to Investing*, you know about my work-out period and some of the different lessons I learned from the process.

On that day back in 1979, rich dad taught me one of the lessons that has proven priceless. On that day he said, "The rich have more debt than the poor. The difference is that they have good debt and the poor and middle class are loaded up with bad debt." Rich dad went on to say, "You should treat all debt, good or bad, the same way you treat a loaded gun… and that is with a lot of respect. People who do not respect the power of debt are often financially wounded by it… sometimes killed. People who respect and harness the power of debt may become rich beyond their wildest dreams. As you now know, debt has the power to make you very rich and it also has the power to make you very poor."

Harnessing the Power of Debt

There are many reasons that I do not join the bandwagon that says, "Cut up your credit cards, get out of debt, and live below your means." I do not say it because I don't think that advice solves the problem for anyone who wants to be rich. For people who want to be rich, have a lot of money, and enjoy the lifestyle that money can bring, simply cutting up your credit cards and getting out of debt does not solve that problem… nor does it necessarily make people happy. I do agree that, on just basic financial principles, cutting up your credit cards is good advice for *most* people. But simply getting out of debt does not work for anyone who wants to become rich and enjoy life. If a person wants to become rich, a person needs to know how to get into *more* debt, learn how to *respect the power* of debt, and learn how to *harness the power* of debt. So if people are not willing to learn how to respect and to harness the power of debt, then cutting up their credit cards and living below their means is great advice. Either decision has a price tag attached.

A Great Used Car

A friend of mine came to the house a few months ago to show me his new car. "I got an amazing deal," he said. "I paid only $3,500 for it, put in $500 for some parts, and it runs great. I could easily sell it for $6,000." He then said, "Come on. Sit in it. Take it for a spin." Not wanting to be rude, I did as he requested and took the car for a ride around the neighborhood. At the end of the test drive, I smiled and said, "It's a great car." But silently I said to myself, "It needs a paint job, the interior smells of old cigarettes, and I would not want to own such a depressing vehicle." Taking back the keys, he smiled and said, "I know it's not a thing of beauty, but I paid cash for this so I have no debt." As he drove off, white smoke poured from the exhaust.

If You Want to Get Richer, Buy a New Car

My wife, Kim, drives a beautiful Mercedes convertible. I drive a Porsche convertible. Even when we were broke we drove Porsches and Mercedeses, or other fine cars. We did not pay cash; we borrowed money to buy them. Why? Let me explain with the following story, a story I often tell in my seminars. It is a story about good debt and bad debt, and enjoying the finer things of life.

In 1995, I received a phone call from my local Porsche dealer. He said, "The car of your dreams is here." I immediately drove down to his showroom to look at a 1989 Porsche Speedster. I already knew that there were only 8,000 of this model made over a three-year period. In 1989, Porsche devotees were buying them, putting them on blocks, and storing them. If you could find a collector who would sell one, the asking price was $100,000 to $120,000 in 1989. But in 1995, I was looking at the rarest of all the 1989 Porsche Speedsters. This was Speedster number one, the first ever built of this model, and it had the Porsche turbo body, which means little except to a dedicated Porsche fan. Since it was the first one built, it was the model that the factory toured all over the world at auto shows and was the car used for the photo on the brochure. The car also came with a special plaque from the Porsche factory. In 1989, after the tour was over, this car was also put up on blocks and stored in a warehouse. When a collector decided to sell it in 1995, the dealer called me. The dealer knew it was the car I had been looking for. The car may have been used, but it had only 2,400 miles on it.

My wife, Kim, watched me go into a hypnotic state as I walked up to the car of my dreams. I sat in the car, took hold of the steering wheel and inhaled deeply, smelling the rich scent of leather, which was still with the car. The car was absolutely flawless and the color was perfect, a shade Porsche calls "metallic linen." Kim looked at me and asked, "Do you want it?" I responded with a nod of my head and smile. "Then it's yours. All you have to do is go find an asset to pay for it." Again, I nodded, climbed out of the car, sniffed the tires, and smiled. It was the car of my dreams and it was mine. We put a deposit on the car, arranged financing with the dealer, and I went out to find the asset that would pay for the car. In other words, I was going to find an *asset* to pay for my *liability* and use *good debt* to pay for the *bad debt*.

A little over a week later, I found a great piece of property, borrowed money to buy it, and the cash flow from the property paid for the debt on the Porsche. A few years later the Porsche would be paid off, and I would still have the cash flow from the property. In other words, instead of getting poorer from having an expensive liability, I got richer *and* have the car of my dreams, which is still mine today. We did the same thing when my wife found the Mercedes of her dreams.

The Best Things in Life Are Free

There is a saying that goes, "The best things in life are free." And I agree. A simple smile can make so many people happy, and a smile costs nothing to give. A pat on the back with the single word, "Congratulations," costs nothing and it can brighten up a person's whole day. A sunrise or full moon costs nothing to appreciate. So in my opinion, the best things in life are free. What I am talking about in this section are the finer things in life that cost money. The kind of happiness I am talking about is the happiness one finds from material things. I am not writing about inner happiness, because material possessions cannot give you that if you do not have it. Inner happiness is free… and priceless if you have it. While each of us has free access to our own inner happiness, not all of us find it.

The Importance of Standard of Living

If I were in high school, my friend's $3,500 dollar bargain-mobile would have been my dream car. I would have driven that car with pride and showed it off to all my friends. But when I was in my forties, driving around in a cheap car was not my idea of a dream. At issue is something called your standard of living, which is a measure of your material happiness and satisfaction. There are three reasons why being aware of your material happiness or changes in your standard of living is important. They are:

1. *Your standards change*. As we age, our standards change because we are changing. If a person finds their tastes improving but their ability to afford their refinements in taste do not change, that person may begin borrowing, increasing their share of bad debt, in order to afford these changes. If your standards change, especially to the more expensive side, it is important to find ways of increasing your income in order to afford these changes.
2. *It is important to respect these inner changes in material standards*. A person's inner happiness can be affected if their material standards change but the person is not able to keep up financially with these changes. For example, I might be a happy high school boy with a $3,500 used car, but I would be an unhappy adult driving the same car I dreamed of in high school. Today, I meet many people who lack inner peace because they have not kept up with the changes in their desire for the finer things in life. I meet many people who are unhappy, living below their means, trying to be happy by only buying things that are cheap, affordable, but below their personal standards, which have improved.
3. *You spend less if you buy what you desire*. I am very happy with my car and my wife is happy with hers. We may have spent more being clear on satisfying our material standards, which includes our house and clothing, but

we actually spend less in the long run in time, money, and happiness because we buy what we want.

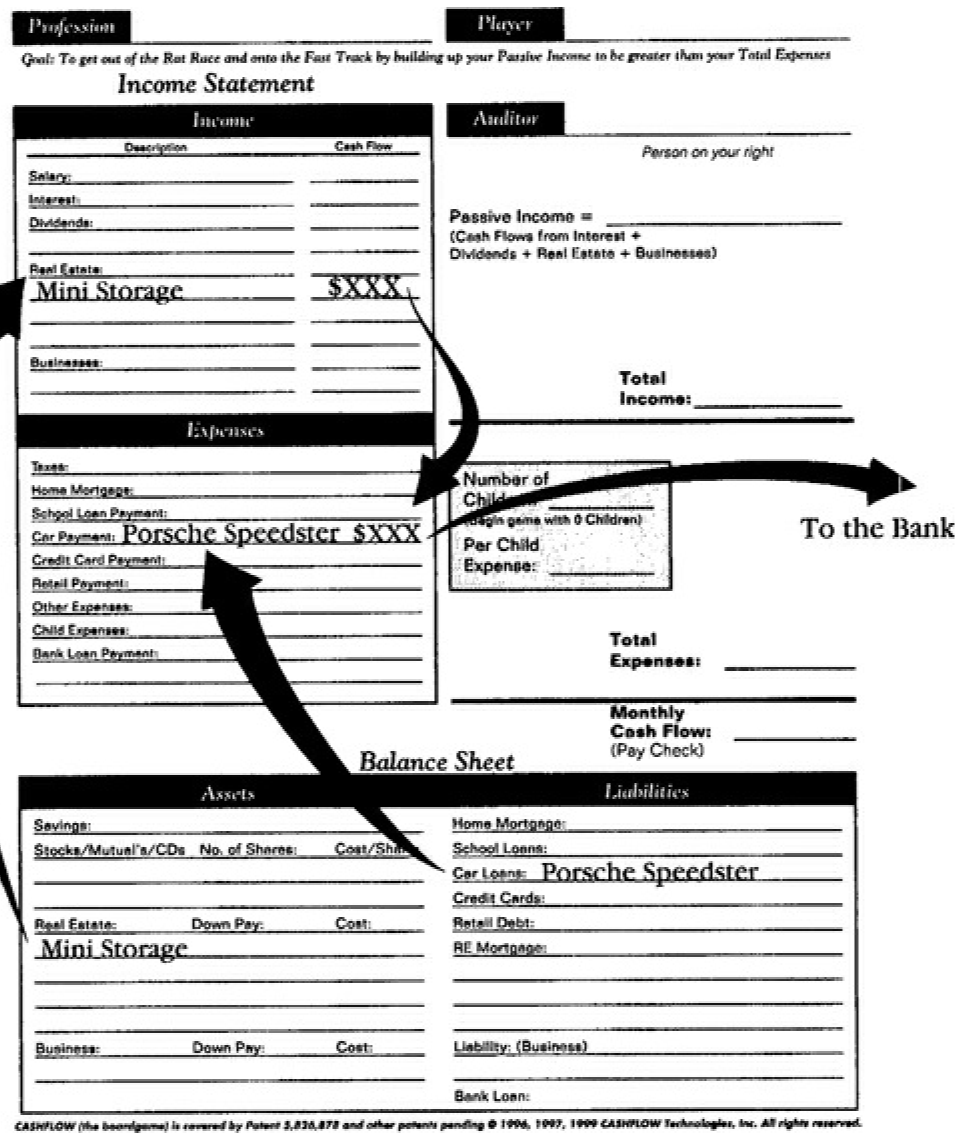
The Lessons Learned

Years ago, my rich dad said, "Some people believe that God wants us to live frugally and to avoid the temptations of the finer things in life. There are other people who believe that God created these wonderful creations for us to enjoy. It is up to you to choose what kind of God you want to believe in."

I tell this story not to tell you that I have the car of my dreams but because I want you to have the wonderful material things this world has to offer—without sacrificing your financial well-being and winding up in financial hell. I tell this simple story of my Porsche for the following lessons about abundance:

Lesson #1: The Importance of Good Debt and Bad Debt

As stated earlier, rich dad stressed the importance of financial literacy and that your financial statement is your report card once you leave school. The following is a diagram of the Porsche transaction:



This an example of a financial statement showing my Assets buying my Liabilities aka: why the rich get richer

As you can see from the diagram of the financial statement, I borrowed money for both the real estate investment, in this case a mini-storage project in Texas, and for the Porsche. The cash flow from the investment covered the monthly costs of the Porsche. Because of good management, the cash flow from the mini-storage greatly increased and the Porsche was paid off two years early. Today, Kim and I have the real estate, the cash flow, and the Porsche. We did a similar process buying her Mercedes. So we got richer while we were also able to drive the cars of our dreams. Our friends, the couple who live above their means and who drive the cars of their dreams, get poorer instead of richer because tile income from their jobs is their only source of income. They look good physically on the outside, but I suspect financial worries from bad debt are eating them alive on the inside. They are buying liabilities with bad debt, instead of assets with good debt.

Buying assets with good debt that provide the cash flow for paying for the things you want in life is what rich dad taught me. The cash flow from your assets represents your money working for you, something my friends and many people today still do not understand.

Who Are You Really Working For?

When it comes to good debt versus bad debt, let me repeat what rich dad often said to me: “Every time you owe someone money, you become an employee of their money. That is, if you take out a thirty-year loan, you’ve instantly become a thirty-year employee. Unfortunately, they do not give you a gold watch when the debt is retired.”

Rich dad did borrow money, but he did his best to not become the person who actually paid for the loans. That’s the key. His advice bears repeating. He would explain to his son, Mike, and me that good debt was debt that someone else paid off for you, and bad debt was debt that you paid for with your own sweat and blood. His love of rental properties was based on “the bank gives you the loan—but your tenant pays it off for you.”

Let me use a typical real-life example to illustrate just how this works. Assume that you find a nice little house for sale in a decent neighborhood. True, the home needs some fixing-up—perhaps a new roof, new gutters, and maybe a new paint job. But by and large, it’s surrounded by other homes that are fairly well maintained, the neighboring area is solid, and the schools are good. Even better, the neighborhood is right next to a local state university, which is always looking for more housing for its students as the enrollment on the campus continues to increase year after year.

The homeowner wants to retire and move to someplace warm and sunny. He’s asking $110,000 for his house. You negotiate a bit with him, and you finally settle on a price of $100,000. You already have $10,000 saved up in your bank account, so you need to get a mortgage for at least $90,000. But in truth, since that $10,000 is pretty much all the cash you have on hand, you decide to apply for a mortgage for $100,000. Why? Because with that extra $10,000, you can pay off the bank’s closing costs as well as pay a local handyman to paint the house and repair the roof and gutters.

In most cases, the bank will be happy to give you the mortgage. Why? Because the mortgage is secured by the collateral value of the house. That is, if you went to a bank and asked for a loan of $100,000 and you didn't have any collateral or secured assets to back it up, the bank would tell you to take a hike. But with the house property backing you up, then the bank will gladly help you finance the loan. Remember, the bank is in the business of making loans—and will do so when they know that there's real collateral to help secure that loan.

Let's move on. Under current finance rates, the bank gives you a thirty-year mortgage at a rate of 6 percent. First, of course, they want that $10,000 as a cash down payment, which you give them. Once you figure in your property taxes, your monthly mortgage payment is going to be about $700. But as mentioned before, you don't want to be an employee of that bank loan for the next thirty years. The better approach is to have someone else pay off that debt for you.

Rich dad would suggest that once you close the deal and own the home, you then start talking to the local university about the availability of your home to be rented by students. Let's say that you charge $1,000 a month for the rent. If the home has four bedrooms, it could easily accommodate four students, each of whom would pay $250 a month. That's a fairly modest amount even for the most cost-conscious student.

Or, you can simply check with a local real estate agency to see if they can handle the rental of your property. For a small monthly maintenance fee, many real estate agencies will not only find a renter for your property, but will also take care of any minor handyman issues, such as fixing a clogged toilet.

Here's more good news. If your rental property is earning you $1,000 a month, and your mortgage payment is only $700, then your monthly net is $300 a month. This net income is what is known as *passive income*. That is, you're not doing any heavy lifting or hard labor to earn it. Someone else, your tenant, is paying off your thirty-year mortgage for you, and even better, you're earning an extra $300 a month.

Rich dad's real estate investing philosophy is primarily based on cash flow. Are you having a positive cash flow at the end of each month? But there is also the popular philosophy that real estate generally goes up in value. While you're earning that extra income each month, you're also paying down that mortgage month by month. That means that very slowly but steadily you are building more equity in the home. Since most real estate properties are believed to gain in value over time, your original investment of $110,000 in that home should also be appreciating in value. In other words, if ten years from now you decide you want to sell the home, the market value of the house might have gone up to $125,000. So, on paper, you would make a nice tidy profit of $15,000 from the sale of the house as well, as well as all the passive income you collected as well. But a word of rich dad caution: "Always keep your eye on your cash flow. Look at potential appreciation in real estate as a bonus, not as a reason to buy."

Take a Tip from Those Who Have Taken Control

Take a look at one of my previous books, *Rich Dad's Success Stories*. That's a collection of success stories of everyday people from all over the United States (as well as a few from around the world) who were fed up living paycheck to paycheck. They just got tired and frustrated of trying to count the years until they could retire and then theoretically live off their 401(k)s (assuming that their 401(k)s still had enough money in them to allow them to retire). In that book, you'll find easy-to-follow firsthand accounts of people—some as young as teenagers, some nearing retirement—who have followed rich dad's advice and started to develop steady streams of passive income.

Many of those success stories are built upon real estate investing. All of the people in the book tell about how they had to overcome their fear of taking that initial financial leap of faith to find that first investment property and then making it happen. But invariably, once they started to see the stream of passive income develop, they almost all went back and repeated the process again… and in many cases, again and again. Some of those folks have gone on from simple one-family properties to larger properties, and all of them point to rich dad's advice as having led the way for them.

In some of the success stories, the individuals decided to invest in small businesses in order to earn their financial freedom. One of the chapters profiles a woman who started to invest in laundromats. As soon as she and her husband found that it was a fairly safe and easy investment to make, they then invested in two more. Now, she and her husband are doing quite well financially, and they'll be the first to tell you that it was simply a matter of doing some financial homework and making their money work for them, rather than them working for their money.

The point is that most people can't seem to get ahead financially because of the monthly onslaught of bills to pay. It's only when they finally make up their minds to do something about their financial lifestyle that they find the self-determination to look at other ways of generating money. And as rich dad says, if you want to get out of the rat race, then you had better start learning about the different types of income: earned, portfolio, and passive. Whether it's investing in real estate, or business, or other kinds of investments, the sooner you discover that there are lots of easier and better ways to make money than just having a job, the better off you and your family are going to be.

Lesson #2: The Power of Inspiration

Let's get back to the used car story. When I drove my friend's bargain used car, I felt depressed. Sitting in the car did not inspire me. I did not hear angels singing and the heavens opening up with blessings as I did when I sat in my Porsche. As my friend drove away, with smoke pouring out of the exhaust pipe, I felt nauseated. In contrast, when I open my garage door and look at my Porsche, I still hear the angels singing. I love that car and I love the inspiration it gave me to go out and invest in another property. In other words, that car gave me the inspiration to get richer. Sitting in my friend's car only inspired me to take a bath.

I believe our maker assists us humans in building beautiful things. When I see a beautiful painting, or a beautiful home, or a beautiful car, I feel inspired. I feel the generosity, the beauty, and abundance of God, and it inspires me to go out and invest more vigorously—but by investing harder, not by working harder.

I notice that people who treat themselves poorly are often *not* the most inspiring people to be around. I have some close friends who are so cheap that when I am in their house, I feel like I am in my friend's used car. I love my friends dearly and I do not impose my financial views on them. But they work hard at living below their means, while Kim and I work hard to continually expand our means, and that makes a big difference in the way we live our lives. As I said, we are all different and we make different choices in our lives. I am simply sharing with you how my wife and I use the luxuries of life to inspire us to become richer.

Lesson #3: My Banker Loves to Lend Me Money for Both Assets and Liabilities

My contention in *Rich Dad Poor Dad* that your house is not an asset has created a lot of controversy. In fact, I get more angry mail about that than any other point in my books. I often say, "When your banker says your house is an asset, he or she is not lying to you. He or she is just not saying whose asset it really is. Your house is *his* asset." I also state, "I'm not saying, 'Don't buy a house.'; All I am saying is, 'Do not call a liability an asset.'" Still, the mail comes in. If you are uncertain about why your house is not your asset, but the banker's asset, you may want to reread my other books.

There is a point I want to take further in this book. Your banker will lend you money regardless if you buy an *asset* or a *liability*. Your banker does not tell you which one to buy. So if you want to buy a new speedboat, and your financial statements show that you can afford the payments, the banker will be more than glad to lend you the money. If you want to buy a three-bedroom home that you'll use as a rental property that makes you money, and your financial statement is favorable, the banker again will generally lend you the money. Why? Because regardless if you borrow money for a liability or an asset, *to the banker, either one is an asset*. So people who first borrow money to buy assets usually end up with more money to buy liabilities. People who only buy liabilities often have no money left to buy assets. The point is, since your banker does not really care which you buy, assets or liabilities, because either one is an asset to the bank, then maybe *you* should care. In fact, the more you care, the happier the banker is because the banker's job is to lend you more money, not turn you down for your loan. Bankers do not make money unless you borrow money, so the richer you become, the happier your banker also becomes. I love my banker because my banker lends me money to buy assets as well as liabilities.

Lesson #4: What Asset Does Your Banker Love the Most?

A radio host asked me, "What do you invest in?" I replied, "I began investing in real estate in my twenties, so the bulk of my investments are in real estate today. I also own businesses and some paper assets such as stocks, bonds, and mutual funds."

The interviewer then said, "I don't like real estate. I don't want to fix toilets and receive phone calls late at night from tenants. That is why I don't invest in real estate. Everything I have is in stocks or mutual funds." He then ended the interview, cut to a commercial break, and I was ushered out of the studio.

An Expensive Idea

Later that evening, I reflected on that interview. I said to myself, "What an expensive decision that radio interviewer has made. He does not want to invest in real estate because he does not want to fix toilets or receive phone calls in the night. I wonder if he knows how much that single idea is costing him?"

In our third book, *Rich Dad's Guide to Investing*, I wrote about the three primary asset classes a person can invest in. They are:

1. Businesses
2. Real estate
3. Paper assets

As I sat there quietly that evening, I could hear rich dad saying to me, "Which one of these three asset classes does my banker love the most?" The answer is real estate. Of the three assets, it is very difficult to receive a loan to start a small business. You might get a small-business loan but those loans often require you to pledge your other assets as security.

It is also very difficult to get your banker to lend you money to buy paper assets. Your banker may use your paper assets as collateral, and then loan you the money personally. *Rarely will a banker lend you money for thirty years at 8 percent to buy paper assets, but your banker will loan it to you to buy real estate.*

Years ago, rich dad said to Mike and me, "If you want to be rich, you must give your banker what he wants. First of all, your banker wants to see your financial statements. Second, a banker wants to lend you money to buy real estate. Just know what your banker wants and you'll find it easier to become rich." That is one of the reasons I said that the radio host's prejudice against real estate was expensive. It is an expensive idea because he will have to use his own, after-tax dollars to buy stocks, bonds, and mutual funds without the leverage of his banker's money. He had to use the most expensive money of all, his own money that comes from his labor, after the government has taken its share in taxes.

Let's use a $10,000 example to illustrate this point.

If the radio host buys mutual funds, all he can buy is $10,000 worth. If the host were to buy real estate, it would be fairly easy to buy a $100,000 property with $10,000 and $90,000 borrowed from the bank. I am also assuming that the property has a positive cash flow, which means that the tenants' payments cover all expenses and the cost of the bank's mortgage as well as providing some income. Let's say the markets are good and each asset goes up 10 percent that year. The mutual funds will gain for that investor $1,000 and the real estate will gain for the investor $10,000, plus the income from cash flow, plus depreciation, plus no capital gains tax (in America, if a tax-deferred exchange is used at the time of sale). The mutual fund probably does not have any cash flow, is not entitled to depreciation benefits, and is taxed at capital gains tax rates if outside a pension plan.

This is not to say paper assets are bad. I have substantial holdings in stocks and mutual funds. The point illustrated here is the cost of the idea "I don't invest in real estate." To me, the biggest expense of all is personal freedom. For Kim and me, the best thing about real estate is the monthly *passive* cash flow income, taxed at a lower rate than *earned* income, which allows us to be financially free. In other words, real estate allows us to have good debt, and good debt is debt that makes us richer quicker. But in utilizing leverage, or the bank's money, to get richer quicker, there is a price to pay.

If you look at the returns on your capital, by using no leverage, your return on $10,000 is 10 percent. But by using the bank's money, your return is 100 percent on *your* money. That also means that the real estate market would need only go up by 1 percent to have the same return as the paper market going up by 10 percent. When you factor in the tax advantages, the real estate market can improve by less than 1 percent to have the same net return as a paper market improving by 10 percent. Those are some of the reasons why rich dad said, "Always give the banker what he wants." And why he also issued these words of caution: "Always treat any debt as you would a loaded gun." The reason is because leverage can swing both ways with equal force, meaning you can make a lot more money using the bank's money—and you can lose a lot more money using the bank's money. So the price to pay is an investment in your education and several years of experience. If you are not willing to pay that price, do not use other people's money. Use only your own money and play it safe.

Paying the Price for Education

As I mentioned earlier, in the 1970s, I invested in that real estate investment class, which cost $385. That three-day course has been one of the best investments I have ever made. I started slowly with small investments and invested another five years gaining the experience I needed. I too do not want to fix toilets, nor do I want to receive phone calls in the night… and I don't. But I do like what my investment in real estate brings me, and that is a lot of good debt and a lot of freedom.

At a recent real estate seminar in Dallas, Texas, where I was the guest speaker, a man of about sixty years of age approached me. He had heard me say, "My rich dad taught me to be a real estate investor by playing Monopoly, and we all know the formula for great wealth found in that game. And the formula is, buy four green houses and turn them into one red hotel."

This gentleman came up to me and said, "Should I turn my houses into red hotels?"

I smiled and asked, "How many houses do you have?"

He thought for a moment and said, "A little over 700."

"What?" was all I could say in response to him.

Sitting down to find out more, I learned that he was a rancher out in West Texas. For the last forty years, he would buy a few houses a year and rent them out. He went through the booms and busts of both the oil and cattle businesses of West Texas. When it was a bust economy, he would buy houses from people who were in financial trouble, and often rent them back to them. As his cash flow grew he just kept buying more houses, most under $65,000, and he never sold any. At the time of our meeting, I found out that he was averaging $200 a month per house in positive cash flow. I gasped and said, "You mean you have over $140,000 in monthly income? Over $1 million a year just from rental property?"

"Yup," he said. "That is why I came to ask you if you think I should start selling some of my green houses and start buying some of them red hotels. It takes a lot of time buying those little green houses. So I like your idea of buying bigger buildings. Then I don't have to buy as many."

I shook my head and laughed and said, “The next seminar we have, I want you to be the speaker and I’ll be the student.” I then gave him the name and number of my financial and tax advisors and told him to call them. I told him that he was far beyond me. As he thanked me for the phone numbers, my mind drifted back forty years to memories of my rich dad playing Monopoly with Mike and me. I was playing Monopoly with little green plastic houses, and the gentleman walking away from me was playing the game for real. I could hear rich dad saying to Mike and me, “My banker always wants to lend me money to buy more real estate. So I always give my banker what he wants.”